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216056
ORIGINAL



BY HAND

March 22, 2006

Honorable Vernon A. Williams
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

RE: STB Docket No. AB-1081X, San Pedro
Railroad Operating Company, LLC-Abandonment
Exemption-In Cochise County, AZ,

Dear Mr. Williams:

On behalf of San Pedro Railroad Operating Company (SPROC), I am enclosing for filing in the above-captioned proceeding an original and ten copies of its Reply to Request to Set Terms and Conditions of Sonosa-Arizona International LLC.

Please date stamp and return one copy for my records.

Sincerely yours,

John D. Heffner

Enclosures:

cc: David Parkinson
David Konschnik, Esq. (by fax)
All parties

ENTERED
Office of Proceedings
MAR 22 2006
Public Record

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB DOCKET NO. AB-1081X
SAN PEDRO RAILROAD OPERATING
COMPANY, LLC-ABANDONMENT EXEMPTION-
IN COCHISE COUNTY, AZ

ENTERED
Office of Proceedings

MAR 22 2006

Part of
Public Record

SAN PEDRO RAILROAD OPERATING COMPANY, LLC
REPLY TO
REQUEST TO SET TERMS AND CONDITIONS

John D. Heffner
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Attorney for San Pedro
Railroad Operating
Company, LLC

Dated: March 22, 2006

EXPEDITED HANDLING REQUESTED

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB DOCKET NO. AB-1081X
SAN PEDRO RAILROAD OPERATING
COMPANY, LLC-ABANDONMENT EXEMPTION-
IN COCHISE COUNTY, AZ

SAN PEDRO RAILROAD OPERATING COMPANY, LLC
REPLY TO
REQUEST TO SET TERMS AND CONDITIONS

BACKGROUND

This pleading represents the response of San Pedro Railroad Operating Company ("SPROC") to the delayed Request to Set Terms and Conditions of Sonora-Arizona International LLC ("SAI")¹ that should have been filed on March 15, 2006 under the Board's rules and was filed March 17, 2006. SPROC requests that the Board deny the relief sought by SAI, setting the purchase price for the subject railroad line at \$5,650,000, and setting other purchase terms and discussed at more length herein. For the reasons stated herein, SPROC asks that the Board promptly grant its requests so that salvage can begin at the earliest opportunity.

¹ In its previous filings SPROC had identified SAI as Sonora.

As background, the Board granted SPROC's request to abandon the subject railroad line in a decision served February 3, 2006. Subsequently, over SPROC's objections and in a decision served February 15, 2006, it found SAI financially responsible and its offer reasonable. Consistent with 49 U.S.C. 10904 and the underlying regulations, the Board gave SAI until March 15, 2006, to either reach an agreement with SPROC or file a Request to Set Terms and Conditions. As SPROC noted to the Board in its letter dated March 16, 2006 (hereafter cited as "the Letter"), it did neither. Instead it filed an unprecedented petition for "clarification" and a 30-day extension for filing its Request to Set Terms and Conditions. The alleged basis for this request was the assertion that SPROC had during negotiations increased the sale price of the line from \$5,400,000 to \$5,650,000 and decreased the amount of track and right of way available for sale from 76.2 miles to 60.9 miles. The Board saw through this ruse and denied SAI's petition. But contrary to statute and the regulations, the Board gave SAI until March 17 to file a proper Request to Set Terms and Conditions, to which this response is directed.

ARGUMENT

Unsupported by any precedent and devoid of any evidence at all (other than a "term sheet" it prepared), SAI wants the Board to order SPROC to sell it 76.2 miles of track and right of way for \$5,400,000 and to indemnify it for all pre-existing environmental conditions regardless of age or amount.

Board precedent and procedures place the burden of proof in a financial assistance proceeding squarely on the offeror, here SAI. See Greenville County Economic Development Corporation-Abandonment and Discontinuance Exemption-In Greenville County, SC, STB Docket No. AB-490 (Sub-No. 1X, served March 16, 2006, slip op. at 2) (hereafter "Greenville") citing Chicago and North Western Transp. Co.-Abandonment, 363 I.C.C. 956, 958 (1981) (aff'd sub nom. Chicago and North Western Transp. Co. v. U.S., 678 F.2d 665 (7th Cir. 1982)). But SAI did not submit any evidence supporting its \$5,400,000 price. In fact, SAI even went so far as to say that "SAI did not [then] and does not now contest the net liquidation value submitted by SPROC as part of its Petition for Exemption..." SAI then stated that "it is submitting no additional evidence here to support that offer," adding "SAI relies on the evidence submitted by SPROC in Exhibit F and elsewhere in its

Petition for Exemption." Request of SAI to Set Terms and Conditions at 2.

As SPROC noted in its letter,

[R]egarding the purchase price, SPROC has consistently valued the line at \$5,650,000. The appraisal prepared by Kenneth Young valued the track material at \$5,400,000. Appraisal at ii. SPROC management valued the right of way at \$247,436 (rounded off to \$250,000) based upon 1265 acres of land held in fee at \$275 per acre. Verified Statement of David Parkinson at 9 and attached letter from Abbott Realty Ltd, Attachment 18. Letter at 3.

SPROC has consistently taken the position throughout the abandonment proceeding that it values the line including track and right of way at \$5,650,000, not \$5,400,000.

Inasmuch as SAI has not submitted any evidence on value, SPROC's valuation represents the best evidence and the only evidence entitled to consideration by the Board.

Greenville, supra at 3.

SAI's then boldly asserted that "SPROC has attempted to remove two of the line segments from the transaction" because SPROC's "counter term sheet" stated with respect to segments (a) and (b), the long abandoned segments between Bisbee and Bisbee Jct. and Paul Spur and Douglas "no track on this segment; (only) railroad locally assessed property." As SPROC again stated in the Letter,

"throughout its two efforts to abandon this line, SPROC had advised the Board that previous owners had abandoned and salvaged portions of the railroad, specifically the branch between Bisbee and Bisbee Jct., and the line between Paul Spur and Douglas.

Petition for Exemption at 8, footnote 5. Deducting the Bisbee Branch and Douglas mileage reduces the total track mileage to 61.4 miles. The track appraisal prepared by Kenneth Young states that the railroad consists of 62.9 miles of main track and sidings between Curtiss (MP 7.0) and a point called Forrest (MP 67.9). Young appraisal at 1. The confidential salvage contract provided SAI reflects 60.9 miles of track. Regarding right of way, SPROC's Environmental and Historic Report indicates that a 20-mile portion of the line consists of an easement over property owned by the Union Pacific Railroad. EHR at 11. SAI cannot claim that SPROC has reduced the amount of railroad for sale." Letter at page 3.

Accordingly, SPROC is not removing any property from this transaction. It will sell all operating property it has the legal power to sell.² To the extent it has the power to convey the right of way on these two segments by quitclaim deed, it will. SPROC can only sell what it owns, no more.

SAI's insistence that SPROC indemnify it against "pre-existing environmental conditions" without any apparent limitation not only contravenes standard railroad industry practice that rights of way are sold "as is." It is contrary to Board policy. Union Pacific Railroad Company Abandonment in Polk County, IA, STB Docket No. AB-33 (Sub-No. 170X, served June 19, 2002), slip op. at 6. In fact,

² The STB does not require abandoning railroads to include "non-corridor" or "non operating property" in forced sale conveyances under 49 U.S.C. 10904. Owensville Terminal Company, Inc.-Abandonment, Et Al, Request to Set Terms and Conditions, STB Docket No. AB-477 (Sub-No. 2X, served Jan. 16, 1998), slip op. at 16. Nowhere does SAI indicate that the rights of way between Bisbee and Bisbee Jct. and Paul Spur and Douglas are necessary for continued transportation or that the economic viability of such service is dependent upon the receipt of rental income from this land. Id.

SPROC's decision to limit its environmental liability for pre-existing claims to one year and \$50,000 is generous by short line railroad standards and reflects the reality that a company like SPROC cannot afford to indemnify a possible future owner for claims that go back to former owners. To the extent that SAI is concerned about a potential environmental liability, SAI's best course of action would be to perform a thorough environmental study of the right of way. Thus far, SAI has not even asked SPROC for a copy of its Phase I report, let alone asked for access to the property to undertake its own study.

Throughout these proceedings and SPROC's previous attempt to abandon this line in Docket AB-441 (Sub-No. 4X), SPROC has repeatedly voiced its concern about SAI's ability to close this transaction. During the March 2, 2006, conference call between the parties, SAI promised to provide financial disclosure and comfort information to SPROC by March 6. That information was never provided. SAI's failure to provide SPROC with some level of comfort about its finances and the identity of its "mystery investor" has been of great concern. Moreover, the marginal level of local traffic on the line, dim prospects for overhead traffic, and substantial sums required for rehabilitation lead SPROC to worry that even if SAI accepts

terms set by the Board, it will not be able to close. Accordingly, SPRCC requests that the Board (1) set an early closing date, no more than 45 days from the date that SAI accepts terms set by the Board, (2) require SAI to tender SPROC a nonrefundable deposit of \$150,000 should it fail to close for any reason (other than one caused by SPROC's actions), and (3) require SAI to deposit the balance of the \$5,650,000 purchase price in an escrow account.

SPROC is particularly concerned about the need for expedition in these proceedings. It has been roughly a year since SPROC first advised Chemical Lime Company of its need to abandon service. Unlike a class I railroad where a retention of a branch line represents but a very small part of its overall operation, the subject railroad is a major component of SPROC's assets. SPROC is accruing principal and incurring interest payments on the debt financing used to acquire this line. By contrast, most class I railroads do not incur any significant costs associated with branch lines because much of their financing comes through equity and these branch lines form a small part of a system that was acquired decades ago and has long been depreciated.

SPROC asks the Board to decide this case in less than the normal 30-day period prescribed in the regulations. Unlike typical financial assistance proceedings where the

Board is asked to review reams of complicated and frequently hard to resolve evidence, this case presents no such challenges. Instead the Board is merely asked to review the parties' pleadings and the relevant law and draft a short decision. Because SAI had previously offered to acquire the subject line within 45 days of completion of its due diligence³, any ruling by the Board requiring closing 45 days from the date of its acceptance of the Board's conditions is reasonable.

SPROC's other closing requests are reasonable. As the Board must be aware, it is the normal, if not standard practice, for the seller of a business to require the buyer to put down a nonrefundable deposit to be applied to the purchase of this property. Many sellers insist upon a ten (10%) deposit. SPROC is satisfied with \$150,000, a far more modest amount. The purpose of this deposit is two-fold: to allow the buyer to demonstrate that it takes the subject business transaction seriously and to compensate the seller for its time and expense should the deal fall through. Here, SPROC is being asked to delay its ability to salvage this asset for several months, representing additional debt interest, real estate taxes, legal fees,

³ SAI's offer states "with closing to occur following the expiration of a forty-five (45) day due diligence period." At 4.

and property maintenance expense that it would otherwise forego. It is also losing interest income on a substantial portion of the salvage value. Buyer will be asked for this deposit at the same time it accepts the Board's terms. Similarly, and at the same time and for the same reasons SPROC is asking that SAI wire transfer the balance of the purchase price (\$5,500,000) into an escrow account to be held pending closing. Should Buyer fail to tender the purchase price deposit by 5PM on the next business day following its acceptance of Board-prescribed purchase terms, the financial assistance process should be vacated and the line authorized for abandonment. Finally, and consistent with STB practice, all property will be conveyed by quitclaim deed.

In conclusion, SPROC requests that the Board deny the relief sought by SAI, setting the purchase price for the subject railroad line at \$5,650,000, and setting other purchase terms discussed herein. Moreover, SPROC asks that the Board promptly grant its requests so that salvage can begin at the earliest opportunity.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'John D. Heffner', with a long, sweeping horizontal line extending to the right.

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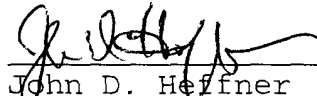
Dated: March 22, 2006

CERTIFICATE OF SERVICE

I, John D. Heffner, certify that a copy of the foregoing Reply To Request To Set Terms and Conditions was served on March 22, 2006 to the following by first-class mail:

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John D. Heffner